No. 12033

In the United States Court of Appeals for the Ninth Circuit

ESTATE OF H. M. HOLLOWAY, DECEASED, HARVEY S. HOLLOWAY, EXECUTOR, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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CITATIONS

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OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 14-25) is reported at 10 T.C. 828.

JURISDICTION

This petition for review involves a deficiency in gift tax in the amount of $6,421.41 for the year 1944. (R. 62-68.) On May 9, 1946, the Commissioner of Internal Revenue mailed a notice of deficiency to the taxpayer, H. M. Holloway, now deceased. (R. 8-9.) Within ninety days thereafter, namely on June 28, 1946 (R. 1), such taxpayer filed a petition with the Tax Court for the redetermination of that deficiency pursuant to Section 1012 (a) of the Internal Revenue Code (R. 4-7).

Inasmuch as H. M. Holloway died on or about October 4, 1947, the Tax Court ordered, pursuant to a motion for substitution of party, that Harvey S. Holloway, executor of the estate of H. M. Holloway, be substituted as petitioner in this proceeding. (R. 12-14.)

On May 13, 1948, the Tax Court entered its order sustaining the deficiency as determined by the Commissioner. (R. 25-26.) Motion for reconsideration was denied by the Tax Court June 15, 1948. (R. 3, 26-32.) Within three months thereafter, namely, on August 9, 1948 (R. 3), there was filed a petition for review by this Court (R. 62-68), pursuant to the provisions of Sections 1141-1142 of the Internal Revenue Code.

QUESTION PRESENTED

Whether, under the provisions of Section 1000 (d) of the Internal Revenue Code, the gift of property here involved must be treated entirely as the gift of the decedent, as the Tax Court held, or whether the decedent's wife had previously received part of the property as compensation for services actually rendered by her and so may be treated as the donor of one-half of such property, as taxpayer contends.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the applicable statute and Regulations involved are set forth in the Appendix, *infra.*

STATEMENT

The facts as found by the Tax Court (R. 16-19) are as follows:

In 1932, decedent and his wife were 63 and 56 years of age, respectively, and neither had any substantial property. During that year decedent obtained a job as watchman for an oil company in Lost Hills, paying $100 per month. He made his home in a small gal-

vanized iron building on the floor of an oil derrick and was joined by his wife there in February, 1933, when she came to care for him after he had fallen and broken some ribs. Except for a few days visit in Los Angeles, she remained with him from that time on and he continued his employment as guard at the oil derrick until about 1935. (R. 16.)

Some time after moving to Lost Hills, decedent took an interest in outcroppings of gypsum in the vicinity of the oil derrick. The first development he did on this project was on property known as the Theta lease. Such work was done with a pick, shovel and a wheelbarrow. He later borrowed a tractor and a plow from a neighbor and plowed the gypsum so that it could be loaded onto trucks with shovels. He would stay at the gypsum property for hours working in the hot sun. His wife, being worried about him, would make many trips to see if he was all right. She would also take him his lunch and water to drink. (R. 16.)

During the fall of 1934, while still employed as watchman of the oil property, decedent had an opportunity to go to work for an oil company in building a gasoline plant located approximately ten miles from the oil derrick where he and his wife lived. This employment lasted six or eight weeks. His wife took care of the gypsum interest at that time while he was away in that she watched the trucks as they would come in, told them where to go to load and where to be weighed, and made a memorandum of names, addresses and truck license numbers of those customers with whom she was not acquainted. (R. 16-17.)

Decedent made frequent trips to the surrounding towns, sixty and eighty miles away, to promote sales of the gypsum and would be gone all day and frequently until late at night. At such times his wife would also look after the property as she had done

before and in the evenings she would usually go with decedent to get the tickets, and then would assist him in computing the poundage and in making up the bills. (R. 17.)

Decedent attempted to interest young men in working with him to develop the gypsum property and on several occasions he persuaded some to come there to work with him for their room and board but they stayed with him for only short periods. The decedent's wife boarded and cooked for the men. Occasionally when the demand arose, decedent would hire as extra help on their days off some of the men working at the oil fields. His wife, in 1934 or 1935, suggested that it would be wise for her to return to Los Angeles to secure employment. He asked her not to do so for no one else would stay there and help him and that if she would remain, half of anything they made would be hers. (R. 17-18.)

On several occasions it was necessary to borrow a few hundred dollars. The notes were signed by both decedent and his wife. Decedent and his wife had a joint bank account but up to 1937 decedent and his wife had accumulated practically nothing. (R. 18.)

Some time during 1937 decedent began operating a larger lease known as the Lang property, which was located about two miles from the oil derrick where he and his wife lived at that time. He paid nothing for the Lang property except a royalty upon extraction of the gypsum. As his activities increased he employed more help, so that by 1941 he had a number of employees. About 1939 the daughter of decedent and his wife came to live with them and help decedent, which relieved his wife of considerable of her duties. Decedent's wife went to the site of the Lang property but a few times. (R. 18.)

Decedent and his wife built a new house in the

vicinity of the oil derrick and moved into it in 1941. (R. 18.)

H. M. Holloway, Inc., was organized about August 1, 1944, at which time eight hundred shares of common stock were issued to decedent in exchange for equipment being used in the business, about $41,000 cash, and leases with Security Oil Company and Richfield Corporation. The assets had been accumulated by decedent and his wife during the period from 1933 to the date of the incorporation, but particularly from about 1937 onward. The Lang lease was not assigned to the corporation but was operated by the corporation under a mining contract from the decedent. (R. 18-19.)

On or about August 21, 1944, gifts of the common stock of this corporation were made to H. S. Holloway, Marian S. Knox and Claude O. Knox. Within the time required by law, decedent and his wife filed separate gift tax returns for the year 1944, on which each reported one-half of these gifts in the amount of $48,562.50, and each paid the tax shown to be due thereon in the sum of $352.03. The Commissioner determined that these properties were community properties of decedent and his wife, Mary L. Holloway, and that none of these had been received as compensation for personal services actually rendered by Mary L. Holloway or derived originally from such compensation or from the separate property of Mary L. Holloway. (R. 19.)

The Tax Court held that the entire amount of the gifts was taxable to the decedent. Accordingly it decided that there is a deficiency in gift tax of $6,421.41 for 1944.

SUMMARY OF ARGUMENT

The Commissioner determined that gifts of corporate stock, which were held as community property and which were made by the decedent and his wife in 1944 should be treated, under Section 1000 (d) of the Internal Revenue Code, entirely as gifts of the husband and the Tax Court correctly approved the Commissioner's determination. That section provides a method for taxing gifts of community property, and holds that all gifts of such property shall be considered gifts made by the husband except that gifts of such property as may be shown to have been received by the wife as compensation for services actually rendered by her, or to have been derived originally from such compensation or to be from her separate property, shall be considered to be gifts of the wife. This statutory provision is clear and unambiguous and places the burden of proof on the taxpayer here.

Thus the question presented to the Tax Court was one of fact and the evidence fails to sustain the taxpayer's burden. While there is some evidence that the decedent's wife rendered slight services in the early years of the project involved here, she admitted that during such period they had accumulated nothing. Moreover, the evidence also indicates that it was only after her services ceased and after the decedent began operating in a larger way under a new lease that cash and other property was acquired. It was such cash and property that was turned in by the decedent in exchange for the corporate shares which were soon after given to his two children and son-in-law.

There is also a failure of proof as to the value of the services which were rendered by the wife. Thus, even if such services could be recognized here, and we do not concede that they can, it is not possible to say what part of the gift property could be treated

as coming from her, but such determination is necessary in order to relieve a husband from paying tax on the entire gift of community property.

ARGUMENT

The Tax Court Correctly Held that the Estate of the Deceased Donor was Liable for all of the Gift Tax Due on Account of the Gifts of Community Property Involved Herein

As the Tax Court pointed out (R. 20), it is conceded by the parties that the question here is controlled by Section 1000 (d) of the Internal Revenue Code (Appendix, *infra*). The provisions of that section were enacted in 1942. (See Section 453 of the Revenue Act of 1942, c. 619, 56 Stat. 798.) Prior to that time, the gift tax law contained no provision as to the manner in which gifts of community property were to be taxed. Because of this absence of legislative directives, gifts of community property were then considered as being one-half from the husband and the other half from the wife. But this was changed by the enactment of Section 1000 (d), which prescribes, for the first time, a method for taxing gifts of community property. This method was in force during 1944 when the gifts here were made [1] and the validity of such statutory provision has been upheld. *Beavers* v. *Commissioner,* 165 F. 2d 208 (C.C.A. 5th), certiorari denied, 334 U. S. 811; *Francis* v. *Commissioner,* 8 T.C. 822.

Under the method provided in Section 1000 (d), all

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[1] While the above section was unquestionably in force during 1944 when the gifts here were made, it was amended by Section 371 of the Revenue Act of 1948, Public Law 471, 80th Cong., 2d Sess., and does not apply to gifts made after the enactment of that Act (i.e., after April 2, 1948).

gifts of community property are to be considered as gifts of the husband except—

> that gifts of such property as may be shown to have been received as compensation for personal services actually rendered by the wife or derived originally from such compensation or from separate property of the wife shall be considered to be gifts of the wife.

The language of the above provision is so clear there can be no question as to its meaning and no need for interpretation. Thus it is evident that in order to divide a gift tax on community property between a husband and a wife, they must actually have made a gift of some property which was "economically attributable" to her. Section 86.2(c), Treasury Regulations 108 (Appendix, *infra*). And where, as in this case, the wife has no separate property of her own, the property which is given away must have come to her as compensation for personal services actually rendered or it must have been derived originally from such compensation. Consequently, to establish his contention here, the taxpayer must show that Mrs. Holloway actually comes within one of these exceptions. This means that the taxpayer had the burden of proof and that the primary question presented to the Tax Court was one of fact.

The Tax Court reached the conclusion that the gifts of property here (i.e., stock of H. M. Holloway, Inc.) were not economically attributable to the wife and accordingly held that her husband's estate was liable for the entire tax. The Tax Court's decision is amply supported by the evidence.

The taxpayer called only two witnesses. The first was the son of Mrs. Holloway. He testified at first that his mother "looked after various phases of the business" when his father was "out on the job" (R.

40), but on further questioning he admitted that he made infrequent visits to his parents and had no personal knowledge of his mother's actual services. This is also shown in the following testimony (R. 41):

> Q. Do you know how much time she [Mrs. Holloway] devoted to the business of selling gypsum?
>
> A. No, not of my personal knowledge.
>
> * * * * *
>
> Q. Well, Mr. Holloway, can you tell me anything specifically that your mother did in connection with the conduct of this business and how much time she devoted to it?
>
> A. I am not competent to tell you that, because I was not there at that time.

Consequently the son's testimony establishes nothing as to the so-called services of his mother, and her testimony, while in more detail, also fails to furnish evidence sufficient to meet the burden here. (R. 43-61.) In the early days of the project here (i.e., during 1934), Mrs. Holloway took lunches and drinking water to her husband where he was working on the Theta lease, nearby their dwelling. (R. 48, 57.) But, as the Tax Court held (R. 22), such services indicate nothing more than a wife's usual duty and does not show that any portion of the property later given away was economically attributable to her.

Other services which Mrs. Holloway claims to have rendered also began in 1934 when her husband was away for about six or seven weeks in the Fall working for an oil company. Prior to that time her husband had been digging out gypsum with a pick and shovel from a hillside on the Theta lease (R. 47) and was selling it to farmers who would come for the gypsum and would do their own loading (R. 48). While her husband was away, Mrs. Holloway looked

after the property. She described her services at that time as follows (R. 49):

> A. Well, I looked after it. I watched the trucks as they would come in, told them where to go and load, told them where to go to be weighed. If I was not acquainted with them I would go up on the hill and get their names and their license numbers and make a memorandum of who they were and where they lived, so that when he came home at night I could give him that information.

Also, a little later on when her husband went away now and then for a day to make sales, Mrs. Holloway stayed at home and "watched things" and took "care of the people as they came". She also assisted her husband some in the evenings "in computing the poundage and in making up the bills". (R. 50.) However, while this indicates, as the Tax Court found, that at one time the wife contributed some services, it also found that these services were performed mostly in the earlier years, that there was only a small amount of savings by 1937 when the Lang lease was taken over, and that property given away here was the result of accumulations in later years. (R. 23.) Thus it concluded that the stock which was given away was not compensation for the wife's services nor derived from such compensation. Since counsel for the taxpayer questions (Br. 15-18) the Tax Court's findings of fact and conclusion, we call particular attention to other testimony, not only as to the nature of her services and when they were rendered, but also as to how and when the gift property here must have been acquired.

When the taxpayer's husband went to Lost Hills (where the gypsum was found) in 1932, he and his wife had exhausted their savings and had no money. (R. 45.) His job at the oil derrick, which he kept for about three years, paid him a hundred dollars a month,

but most all of that was used for living expenses. (R. 47.) The first gypsum lease was the Theta lease and the property it covered was "very small" in comparison with the property covered by the Lang lease, acquired in 1937. In answer to the question as to how much money they had accumulated by the time the Lang lease was acquired, Mrs. Holloway replied that they "had accumulated practically nothing at that time". (R. 54.) This statement is important for, as the Tax Court found, it was during this period that she rendered practically all of her services yet they had practically nothing to show for their work afterward. In spite of this testimony, counsel for the taxpayer assumes that the gypsum business had been prosperous before acquisition of the Lang lease. He also asserts (Br. 18) that the cash that had been previously earned had been invested in equipment, but such statement is unsupported by any evidence.

Mrs. Holloway's son testified that the property turned in for the corporate stock in 1944 included certain equipment used in the operation of the business (R. 38) but neither he nor anyone else told when or how such equipment was secured. However, Mrs. Holloway testified that at first her husband used only a pick and shovel and wheelbarrow; then he used a plow and a Fordson tractor which he rented from a neighbor. (R. 47.) She also explained that at first the farmers did their own loading "with their shovels" and later when "we got going where we had other equipment" her husband used a Fresno scraper which she thought "was borrowed". (R. 48.) Thus there is nothing to show that any sums of money had been invested in equipment by 1937 or in any other assets.

The Lang lease was acquired in 1937, and was of course a valuable asset, but nothing was paid by the decedent for it in advance as it was given to him on

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> A. Well, I looked after it. I watched the trucks as they would come in, told them where to go and load, told them where to go to be weighed. If I was not acquainted with them I would go up on the hill and get their names and their license numbers and make a memorandum of who they were and where they lived, so that when he came home at night I could give him that information.

Also, a little later on when her husband went away now and then for a day to make sales, Mrs. Holloway stayed at home and "watched things" and took "care of the people as they came". She also assisted her husband some in the evenings "in computing the poundage and in making up the bills". (R. 50.) However, while this indicates, as the Tax Court found, that at one time the wife contributed some services, it also found that these services were performed mostly in the earlier years, that there was only a small amount of savings by 1937 when the Lang lease was taken over, and that property given away here was the result of accumulations in later years. (R. 23.) Thus it concluded that the stock which was given away was not compensation for the wife's services nor derived from such compensation. Since counsel for the taxpayer questions (Br. 15-18) the Tax Court's findings of fact and conclusion, we call particular attention to other testimony, not only as to the nature of her services and when they were rendered, but also as to how and when the gift property here must have been acquired.

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The Lang lease was acquired in 1937, and was of course a valuable asset, but nothing was paid by the decedent for it in advance as it was given to him on

the promise of future royalties. (R. 59.) It is evident that the acquisition of this lease marked the turning point in the gypsum development. Up to that time, the decedent, with occasional help from oil men and others, had been digging gypsum from a small piece of land near his home under what was known as the Theta lease, but he had gotten little for his very hard work except experience. It appears that he quit operating under the Theta lease about the time he started operations on a larger scale on the property acquired under the Lang lease in 1937 and he then secured more employees. However, as the latter property was two miles from his home, his wife does not appear to have helped him thereafter. At least, she admitted that she went to the Lang property only a few times. (R. 55-56.) She also testified that in 1939 their daughter, who had come to live with them, helped her father and so relieved her of considerable duties in that respect. (R. 57.)

We submit that it is apparent that during the early years when the wife here was rendering some small services to her husband, they had accumulated no cash or other assets which could be treated as compensation for her services; and it is equally clear that during the period from 1937 to 1944, when cash and other property were acquired, the evidence failed to show that she actually rendered any services. Yet in an attempt to show that Mrs. Holloway was still participating in the business after 1937, counsel for the taxpayer has stated (Br. 17) that there were many services to be performed that did not require her to go to the site of the Lang property, which was two miles from her home. But neither counsel nor the record shows what those "many services" were. However, as we have indicated, it appears from the testimony that operations under the Theta lease (which was near her home) closed about the time operations

began under the Lang lease and that thereafter the customers would not be coming to Mrs. Holloway's house, and the increased number of employees obviously made it no longer necessary for her to help in looking after such customers.

Certainly, in view of this change in the business around 1937, the Tax Court was justified in finding that there was a break in the connection between Mrs. Holloway's services and any later property which was acquired. (R. 23.) But in contending otherwise, taxpayer's counsel points to the finding of the Tax Court that the assets which were exchanged in 1944 for corporate stock were "accumulated by decedent and his wife between about 1933 and the date of the incorporation, and particularly from about 1937 onward". (R. 19.) Of course, it is correct in one sense to say that both husband and wife had accumulated the community property here for, under the law of California, they were equal owners of such property for some purposes. Cf. *Bishop* v. *Commissioner,* 152 F. 2d 389 (C.C.A. 9th). However, that does not mean, and the Tax Court did not intend it to mean, that the wife here actually received part of the gift property as compensation within the meaning of Section 1000 (d), involved here. To reach the latter conclusion, there must be evidence showing that she actually rendered services and that the accumulated property was received by her as compensation for such services, or was derived from such compensation. But, as the Tax Court explained in its opinion (R. 23), while there is some evidence that the property here was accumulated in the latter sense by both husband and wife, there is also evidence showing that the gift property was really accumulated after 1937 and that Mrs. Holloway performed no services after that year. Thus the Tax Court, after considering all the evidence, including that which may seem conflicting, concluded

that no part of the property which was given away in 1944 was economically attributable to Mrs. Holloway's services.

In this connection, the Tax Court called attention to the fact that when the exchange was made in 1944, prior to the gift, there were two leases from oil companies which were given in exchange for the corporate stock along with cash and operating equipment, and that there was no evidence to connect such leases in any way with the services of Mrs. Holloway. Thus, while these leases undoubtedly are valuable assets, there is no evidence to show when they were acquired or what their cost was. Obviously, it is possible that they were acquired by the decedent without cost, as was the Lang lease, and yet could have a high trade-in value. This failure in proof indicates clearly that, even if we could assume that Mrs. Holloway rendered valuable services and that some part of the gift property is attributable to such services as compensation, we still would not know how much those services were worth or how much of the property which was turned over for the corporate stock could be traced to her efforts. However, such determination is necessary in order to meet the requirements of Section 1000 (d).

In attempting to show how Mrs. Holloway helped her husband, counsel for taxpayer also refers (Br. 15) to the fact that when money was borrowed for the business here, she signed the notes along with her husband. Of course this is a customary practice where property is owned jointly or as community property and doubtless did enable the husband to secure needed capital but, as the Tax Court pointed out (R. 22), such cooperation on Mrs. Holloway's part does not bring this case within the statutory provision which refers to personal services and requires that the gift property be traced to those services. It is also not material that the decedent and his wife may have had

an oral agreement that they would share everything equally. (R. 51.) We are not concerned here with the law of contracts but with a particular statutory provision that taxes gifts of community property as if they were entirely made by the husband unless he can show that his wife has received some part of the property, which is the subject of the gifts, as *compensation for personal services actually rendered* by her or that such property is derived originally from such compensation. This being the nature of the statute, it obviously cannot matter here what agreement the parties had or whether they had any agreement. The important thing is whether Mrs. Holloway actually rendered services and, if so, how much of the property which was given away is directly or indirectly traceable to the compensation she received for such services.

The Tax Court found that she rendered no material services in the years when the gift property was acquired and its findings and conclusion based thereon are amply supported by the evidence. Thus it cannot be said that its decision is clearly erroneous or not in accord with the evidence.

CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

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NOVEMBER, 1948.

APPENDIX

Internal Revenue Code:

SEC. 1000. IMPOSITION OF TAX.

(a) For the calendar year 1940 and each calendar year thereafter a tax, computed as provided in section 1001, shall be imposed upon the transfer during such calendar year by any individual, resident or nonresident, of property by gift. Gift taxes for the calendar years 1932-1939, inclusive, shall not be affected by the provisions of this chapter, but shall remain subject to the applicable provisions of the Revenue Act of 1932, except as such provisions are modified by legislation enacted subsequent to the Revenue Act of 1932.

(b) The tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible; but, in the case of a nonresident not a citizen of the United States, shall apply to a transfer only if the property is situated within the United States.

(c) [as added by Sec. 452 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Powers of Appointment.*—An exercise or release of a power of appointment shall be deemed a transfer of property by the individual possessing such power. For the purposes of this subsection the term "power of appointment" means any power to appoint exercisable by an individual either alone or in conjunction with any person, except—

(1) a power to appoint within a class which does not include any others than the spouse of such individual, spouse of the creator of the power, descendants of such individual or his spouse, descendants (other than such individual) of the creator of the power or his spouse, spouses of such descendants, donees described in section 1004 (a) (2), and donees described in section 1004 (b). As used in this paragraph,

the term "descendant" includes adopted and illegitimate descendants, and the term "spouse" includes former spouse; and

(2) a power to appoint within a restricted class if such individual did not receive any beneficial interest, vested or contingent, in the property from the creator of the power or thereafter acquire any such interest, and if the power is not exercisable to any extent for the benefit of such individual, his estate, his creditors, or the creditors of his estate.

If a power to appoint is exercised by creating another power to appoint, such first power shall not be considered excepted under paragraph (1) or (2) from the definition of power of appointment to the extent of the value of the property subject to such second power to appoint. For the purposes of the preceding sentence the value of the property subject to such second power to appoint shall be its value unreduced by any precedent or subsequent interest not subject to such power to appoint.

(d) [as added by Sec. 453 of the Revenue Act of 1942, *supra*] *Community Property.*—All gifts of property held as community property under the law of any State, Territory, or possession of the United States, or. any foreign country shall be considered to be the gifts of the husband except that gifts of such property as may be shown to have been received as compensation for personal services actually rendered by the wife or derived originally from such compensation or from separate property of the wife shall be considered to be gifts of the wife.

* * * * *

(26 U.S.C. 1946 ed., Sec. 1000.)

Treasury Regulations 108, promulgated under the Internal Revenue Code:

Sec. 86.2 *Transfers Reached.*—

* * * * *

(c) *Transfers of community property after 1942.*—During the calendar year 1943 and any calendar year thereafter any gift of property held as community property under the law of any State, Territory, or possession of the United States, or any foreign country constitutes a gift of the husband for the purpose of the gift tax statute (regardless of whether under the terms of the transfer the husband alone or the wife alone is designated as the donor or whether both are so designated as donors), except to the extent that such property is shown (1) to have been received as compensation for personal services actually rendered by the wife or derived originally from such compensation, or (2) to have been derived originally from separate property of the wife. The entire property comprising the gift is prima facie a gift of the husband, but any portion thereof which is shown to be economically attributable to the wife as prescribed in the preceding sentence constitutes a gift of the wife.

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